**DEPARTMENT OF STATE REVENUE**

04-20100724.LOF

**Letter of Findings Number: 04-20100724**
**Sales/Use Tax**
**For Tax Years 2007, 2008, and 2009**

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## ISSUES

**I. Sales and Use Tax** – Imposition.

**Authority**: IC § 6-2.5-1-2; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-9; IC § 6-8.1-5-1; 45 IAC 2.2-3-4; 45 IAC 2.2-3-13; 45 IAC 2.2-4-27; 45 IAC 2.2-5-16; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Brambles Industries, Inc. v. Indiana Dep't. of State Revenue, 892 N.E.2d 1287 (Ind. Tax Ct. 2008); Webster's II New Riverside University Dictionary (1988).

Taxpayer protests the assessment of sales/use tax.

**II. Tax Administration** – Negligence Penalty.

**Authority**: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

## STATEMENT OF FACTS

Taxpayer, a commercial printing company, does business in Indiana. Taxpayer rents or leases certain shipping pallets from a vendor ("Vendor"). Vendor was audited by the Indiana Department of Revenue ("Department"). Based on the information obtained from Vendor, the Department subsequently conducted an investigation of Taxpayer's lease/use of Vendor's pallets for 2007, 2008, and 2009 tax years. Pursuant to the investigation, the Department determined that Taxpayer did not pay sales tax at the time of its lease/use of the pallets; nor did Taxpayer self-assess and remit the use tax accordingly. Thus, the Department assessed additional tax concerning Taxpayer's use of the pallets.

Taxpayer timely protests these assessments. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

**I. Sales and Use Tax** – Imposition.

## DISCUSSION

The Department determined that Taxpayer leased and used the pallets in the course of its business activities in Indiana without paying sales tax or self-assessing and remitting the use tax accordingly. Taxpayer, to the contrary, claimed that it was entitled to a statutory exemption pursuant to IC § 6-2.5-5-9(d).

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Id.; USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466, 468-69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. Id. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

Generally, all "[t]angible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail [sales] tax has been collected at the point of purchase." 45 IAC 2.2-3-4. "[R]enting or leasing tangible personal property" is also subject to sales/use tax. 45 IAC 2.2-4-27(a). Tangible personal property means

personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses. IC § 6-2.5-1-27. Tangible personal property also includes electricity, water, gas, steam, and prewritten computer software. Id.

An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 100-01.

IC § 6-2.5-5-9 states:

(a) As used in this section, "returnable containers" means containers **customarily returned** by the buyer of the contents **for reuse as containers**.

(b) Sales of returnable containers are exempt from the state gross retail tax if the transaction constitutes selling at retail as defined in IC 6-2.5-4-1 and if the returnable containers contain contents.

(c) Sales of returnable containers are exempt from the state gross retail tax if the containers are transferred empty for the purpose of refilling.

(d) Sales of wrapping material and empty containers are exempt from the state gross retail tax **if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds**. (**Emphasis added**).

45 IAC 2.2-5-16 further, in pertinent part, explains:

(a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.

(b) In general the gross proceeds from the sale of tangible personal property in a transaction of a retail merchant constituting selling at retail are taxable. This regulation [45 IAC 2.2] provided an exemption for wrapping materials and containers.

(c) General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property are exempt from state gross retail tax:

(1) **Nonreturnable containers** and wrapping materials including steel strap and **shipping pallets** to be used by the purchaser as enclosures for selling tangible personal property. (**Emphasis added**).

In Brambles Industries, Inc. d/b/a Chep USA v. Indiana Dep't. of State Revenue, 892 N.E.2d 1287 (Ind. Tax Ct. 2008), the taxpayer, on behalf of its customers (manufacturers), claimed that the lease payments for use of shipping pallets were exempt pursuant to IC § 6-2.5-5-9. The manufacturers argued that "the pallets are nonreturnable containers because the retailers do not return the pallets to them." Id. at 1290. To determine whether "shipping pallets" are qualified as "nonreturnable containers," the Indiana Tax Court, in Brambles, stated that:

Nonreturnable containers are defined as "containers which are not returnable containers." 45 IAC 2.2-5-16(e)(2). Returnable containers are defined as "**containers customarily returned** by the buyer of the contents for reuse as containers." A.I.C. § 6-2.5-5-9(a); 45 IAC 2-5-16(e)(1). To the extent that the statute and regulation do not define the word "return," the Court will give it its plain, ordinary, and usual meaning, as defined in the dictionary. See Johnson County Farm Bureau Coop. Ass'n v. Indiana Dep't of State Revenue, 568 N.E.2d 578, 580-81 (Ind. Tax Ct. 1991), aff'd by 585 N.E.2d 1336 (Ind.1992). "Return" is defined as "to pass back to an earlier possessor" and "to bring, send, or put (a person or thing) back to or in a former position." Webster's Third New Int'l Dictionary 1941 (2002 ed.).

**Neither the statute, the regulation, nor the dictionary definition of the word "return" require that the container go back to the person from whom it was immediately acquired in order to be considered "returned,"** as the manufacturers contend. **It is enough that the pallets are "pass[ed] back to an earlier possessor,**" which in this case is Chep. Consequently, **the Court concludes the pallets are returnable containers and therefore the manufacturers' lease payments do not qualify for the nonreturnable container exemption**.

Id. at 1290-91. (**Emphasis added**).

In this instance, Taxpayer argued that its leases/uses of the pallets qualified for the exemption of "nonreturnable containers" under IC § 6-2.5-5-9(d) and 45 IAC 2.2-5-16(c)(1). Taxpayer claimed that "if a company purchases pallets and uses them to ship its products to consignees (with no obligation by the customer to return them), the pallet is a nonreturnable container, and the company is exempt from sales tax on the purchase of the pallets." Taxpayer derived its argument based on one sentence in Brambles decision stating that "the resolution of the issue hinges on to whom the pallets **must** be returned." (**Emphasis on original in Taxpayer's protest letter**). Taxpayer argued that Brambles found the manufacturers' use of the pallets did not qualify for the exemption of "nonreturnable containers" because the manufacturers' customers had the "written contractual obligation" of returning the pallets to the possessor/owner of the pallets, Chep. Taxpayer thus argued

that if there is no written contractual obligation to return the pallets, Brambles is not applicable. Specifically, Taxpayer argued that, unlike the taxpayer in Brambles, it did not have any written agreement with Vendor, which obligated Taxpayer to return the pallets to Vendor. Although Vendor advertised its pallets as "returnable" and attempted to retrieve its pallets either from Taxpayer or Taxpayer's customers, Taxpayer asserted that Vendor "did so on its own initiative." To support its protest, Taxpayer submitted additional documentation, including a copy of affidavit from Vendor and sample copies of its "Purchase Orders" of the pallets and the invoices to its customers.

Taxpayer is mistaken. Neither the statute/regulation nor the Brambles court imposes such requirement of "written contractual obligation" in order to find the pallets are "returnable." Under IC § 6-2.5-5-9 (a), "'returnable containers' means containers customarily returned by the buyer of the contents for reuse as containers." (Emphasis added). "Custom" is defined, in relevant part, as follows:

1. A practice followed as a matter of course among a people.
2. A habitual practice of an individual.
3. A common tradition or usage so long established that it has the force of validity of law.

"Customary" is defined as follows:

1. Commonly practiced: usual.
2. **Based on custom or tradition rather than written law or contract**. (**Emphasis added**).

Webster's II New Riverside University Dictionary 340 (1988). The Brambles court, in concluding that the shipping pallets were "returnable" containers, clearly stated that "[i]t is enough that the pallets are pass[ed] back to an earlier possessor, which in this case is Chep." Brambles, 892 N.E.2d at 1291. Thus, whether there is a written contractual agreement between Taxpayer, its customers (the retailers), and the possessor of the pallets is irrelevant. The question is "to whom the pallets must be returned." Id. at 1290. (Emphasis added).

In this instance, Vendor advertises itself as "the leader in providing plastic returnable pallets to commercial printers." (Emphasis added). Taxpayer is one of the commercial printers who have leased the "returnable pallets" from Vendor. Vendor's advertising also emphasizes its well-coordinated, nationwide pallet return program. Thus, the pallets were customarily returned to Vendor through its well established nationwide returnable/reusable program. Taxpayer may assert that it was not obligated to return the pallets; however, like Chep's pallets in Brambles, the pallets at issue here were customarily "passed back to an earlier possessor," which in this instance was Vendor. Pursuant to the Brambles decision, "it is enough that the pallets are "pass[ed] back to an earlier possessor" to conclude that "the pallets are returnable containers." Therefore, Taxpayer's lease/use of Vendor's returnable pallets, like the manufacturers' lease/use of the Chep's pallets, did not qualify for the nonreturnable container exemption.

In conclusion, as mentioned earlier, a statute which provides a tax exemption is strictly construed against the taxpayer. RCA Corp., 310 N.E.2d at 97. "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 100-01. Given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden of proof demonstrating that it was entitled to the exemption under IC § 6-2.5-5-9(d). Thus, Taxpayer's lease and use of Vendor's returnable pallets were subject to sales/use tax pursuant to the above mentioned statute, regulation, and case law. Since Taxpayer did not pay sales tax at the time of the transactions, use tax is properly imposed.

**FINDING**

Taxpayer's protest is respectfully denied.

**II. Tax Administration** – Negligence Penalty.

**DISCUSSION**

The Department issued proposed assessments and the ten percent negligence penalty for the tax year in question. Taxpayer protests the imposition of penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

(1) fails to file a return for any of the listed taxes;
(2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
(3) incurs, upon examination by the department, a deficiency that is due to negligence;
(4) fails to timely remit any tax held in trust for the state; or
(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

45 IAC 15-11-2(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated

as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), in part, as follows:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;

(2) judicial precedents set by Indiana courts;

(3) judicial precedents established in jurisdictions outside Indiana;

(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;

(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

In this instance, Taxpayer has demonstrated that the imposition of the negligence penalty is not appropriate.

**FINDING**

Taxpayer's protest is sustained.

**SUMMARY**

For the reasons discussed above, Taxpayer's protest of the imposition of sales/use tax concerning its lease/use of Vendor's pallets is respectfully denied. Taxpayer's protest of the imposition of the negligence penalty is sustained.

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